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RUEHMO/AMEMBASSY MOSCOW PRIORITY 3991
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C O N F I D E N T I A L OSLO 000139

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EUR/NB (MMCDOSELL), DEPARTMENT OF COMMERCE (LMARKOWITZ),
DEPARTMENT OF ENERGY (EROSSI, TSARKUS, JGIOVE), INR/I
(SMCCORMICK), EEB/ESC (LWRIGHT); COPENHAGEN FOR ERIK HALL

E.O. 12958: DECL: 03/06/2018

TAGS: ECON ENRG EPET PGOV SENV NO

SUBJECT: NORWAY'S ENERGY PART II: STATOILHYDRO'S SAGA FROM
A BUSINESS PERSPECTIVE

REF: OSLO 126

Classified By: DCM Kevin M. Johnson, Reasons 1.4 (b) and (d)

1.(C) Summary. StatoilHydro, despite suffering from massive growing pains following the recent merger of Statoil and Norsk Hydro, maintains that its ambitious global expansion is on track. The company will continue existing Iranian operations, eyes Caspian energy with interest, and soberly views its Shtokman venture (doubting the aggressive Russian scheduled on-line dates), all while contending with growing domestic political criticism. Energy producer rivals and sector suppliers criticize the company as being directionless, and paying inadequate attention to existing Norwegian Continental Shelf (NCS) operations (including setbacks with the Snohvit project). Suppliers are wary of StatoilHydro's NCS dominance, fearing anti-competition concerns. End Summary

A Giant Finding its Way: The First 100 Days, and Beyond

2.(C) The StatoilHydro merger in October 2007 created a massive Fortune 50 company, holding approximately 80% of NCS operatorships. Growing pains are evident, as revealed in recent meetings with senior StatoilHydro executives. The challenges of the megamerger are startling: during the first 100 days, over 10,000 new on-shore positions were created. The company will only now tackle sifting through the off-shore positions. While trumpeting many impressive statistics (including being the largest off-shore company in the world, large-scale expansion into the Gulf of Mexico and winning 16 leases in the Chukchi Sea, located offshore Alaska), the company has faced many setbacks in Norwegian and international operations. (Reftel A).

Iran: The Beat Goes On...and On

3.(C) StatoilHydro executives confirmed that the company will continue development of Iran's Anaran field. They stressed that StatoilHydro's position should be "no surprise" to the USG: the company will not expand operations, and will only continue its prior contractual obligations. One executive remarked that the "business climate in Iran has been less than inviting," noting massive bureaucratic issues.

The executive noted that Iran cannot launch one LNG project, and cited declining production. Despite having the second largest gas reserves in the world, another executive noted wryly that Iran is becoming an importer rather than a net exporter.

Russian Challenges, New Time Frames

4.(C) Discussions with StatoilHydro moved to the massive Shtokman project, focusing on the company's 24 percent interest in the Shtokman Development Company, which is handling Shtokman field's first development phase. (Note: the Shtokman field is the largest known offshore gas field in the world, situated in the Russian sector of the Barents Sea. Estimates indicate approximately 3.7 trillion cubic meters of natural gas reserves). StatoilHydro's partners are Gazprom and Total, holding 51 percent and 25 percent shares, respectively.

5.(C) The first phase is expected to initially produce approximately 23 bcm of natural gas annually. Development costs for the first phase range widely, from 20-30 billion dollars. Phase one would develop approximately 20 percent of all Shtokman field reserves. StatoilHydro gas experts noted that the project is a technological marvel, which will necessitate breaking 250 world records. Distances are so great that three refueling helipads must be placed along the way to the main site. (Note: official figures indicate an aggressive 2012 opening date. Company experts inadvertently presented an internal PowerPoint slide which indicated a 2016 start date).

6.(C) Statoil experts believe development of Yamal resources

(although Statoil is not directly involved) present massive logistic and infrastructure challenges (including lack of railways, pipelines, and living quarters), but the StatoilHydro executives believe that the project will come on-line in 2014 not the Russian estimated 2012 commencement date. The Norwegians emphasized that the Russian estimates for both Shtokman and Yamal are unrealistic.

Environmental Concerns; Politicians, Public Attack Corporate "Klima-Monster"?

7.(C) StatoilHydro will continue its carbon capture sequestration (CCS) efforts, including the costly, technologically-challenging (and politically important) Mongstad project. Although its CCS efforts receive high praise internationally, company executives frankly say that price considerations (including the GON's hefty carbon dioxide taxes) motivate projects like Mongstad. (Note: StatoilHydro executives downplayed previous concerns that the European Union was balking at approving the project due to the amount of government funding involved). The StatoilHydro team dismissed GON politicians who publicly set a Mongstad opening date of 2014, shrugging off political influences, stating that projects only move forward if they make business sense.

8.(C) The company's investments in Canadian tar sands projects raised public outcry from Environment and International Development Minister Erik Solheim. Solheim's public attack of the company, noting the environmental consequences of the project, were privately brushed aside by the corporate executives. These officials informed EconOff that the Canadian investment was a good business decision, and that political decisions must be separated from the GON's ownership interests. One executive admitted that the public debate placed the company "in the storm's eye," but held that business considerations would ultimately control any investment decision.

9.(C) The StatoilHydro team discussed gas supply to Europe, noting that Norway currently supplies 85-90 billion cubic meters (bcm) per year. By 2020, they estimated that 120-140 bcm of gas will be supplied by Norway, due to successes from ongoing explorations and estimates of yet-discovered fields (Note: these estimates do not include the resources of the Nordland VI and VII fields, located in the Barents Sea off the Lofoten Islands, which are widely believed to hold vast gas resources. The current Norwegian government, facing elections in 2009, has declared those fields off-limits, due to various environmental and fishing concerns.) These estimates also consider "de-bottlenecking," where certain pipeline capacity will be freed due to other declining fields, and the construction of new pipeline infrastructures, as in the Norwegian Sea. Unless there are new discoveries, no additional Norwegian pipelines will be constructed (Note: if Nordland VI and VII open, a new pipeline will be needed, given that high carbon dioxide costs will make LNG cost-prohibitive.)

10.(C) Raising Caspian resources, company executives discussed the Shah Deniz gas project, and branded the Caspian an "interesting" area. The team discussed StatoilHydro's partnering with Swiss EGL in construction of a \$2.18 billion Trans Adriatic Pipeline across the Adriatic Sea. Candidly, they do not believe that the Nabucco and South Stream pipeline projects could co-exist, while also doubting projects requiring future cooperation among Azerbaijan, Turkmenistan, Kazakhstan, Georgia and Turkey--who "rarely agree on anything." All the executives praised USG active diplomatic efforts in the region, which was credited in freeing access to gas reserves.

StatoilHydro: Rivals, Suppliers Criticize New Kid On The Block

11.(C) Meetings with leading American energy industry

suppliers and major energy producers note a marked change in business climate following the Statoil and Norsk Hydro merger. American energy suppliers were candid, saying that the merger evidenced the GON's shocking lack of technical/financial expertise, and argued that direct competition would benefit the GON-controlled mega-giant. Concerned that the StatoilHydro market dominance would be used to squeeze suppliers into less-than-lucrative contracts, executives are suspicious of proposed standardized StatoilHydro contracts with non-negotiable terms and conditions. A country manager remarked that suppliers must "win one of these giant StatoilHydro contracts, or disappear." (Note: Despite criticisms, country managers note that the StatoilHydro procurement wing has invited suppliers to advise/comment on contract standardization.)

12.(C) Energy producers were also highly critical. One manager suggested that StatoilHydro should release some of its NCS operatorships to smaller, leaner companies willing to make more mature fields even more attractive. Another criticism from a country manager was that the company cannot be "everything for everyone." Though growing exponentially, there was doubt that a grand corporate strategy existed, as many NCS projects where StatoilHydro served as operator were arguably getting neglected. Rivals argued that these operatorships should be sold to companies willing to make them more efficient, which would not force the company to replace valuable booked reserves. (Note: Norwegian Petroleum Directorate officials informed Econoff that "many eyes" are on StatoilHydro, and that the company will be monitored to deliver on their existing obligations.) Finally, access to the NCS, given StatoilHydro's operatorship dominance, continues to raise alarms from oil/gas operators.

Growing Pains: Reaching Adulthood Too Fast

13.(C) Comment. Becoming an international energy player

necessarily involves risks, tempering rewards with burdens. StatoilHydro's global designs are indeed ambitious, spanning the deep Gulf of Mexico to the frigid northern expanses of the Barents. But finding one's way in the world takes on added meaning when new projects demand additional resources and contending with new responsibilities, which the beleaguered company now must confront. At home, private sector rivals and suppliers criticize the giant for expanding too fast, while neglecting its core --NCS development and its countless operatorships. Faced with technological setbacks at its marquee LNG project, Snoehvit, in addition to serious political pressures over the company's environmentally-challenged Canadian operations, the company is facing sharp domestic criticism. StatoilHydro's Iranian presence, Caspian projects and Russian adventures seem like daunting challenges for a company perhaps stretched too thin.

End Comment.

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